RIVAL STATES, RIVAL FIRMS

Competition for world market shares

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1 THE NEW DIPLOMACY

The upheavals of the international political economy during the last decade have altered, irreversibly we believe, the relationships among states and multinational enterprises. Growing interdependence – that much abused word – now means that the rivalry between states and the rivalry between firms for a secure place in the world economy has become much fiercer, far more intense. As a result, firms have become more involved with governments and governments have come to recognise their increased dependence on the scarce resources controlled by firms. This mutual interdependence of states and firms throughout the world is the subject of this book; even though the detailed material is drawn from just three countries – Brazil, Kenya, Malaysia – we believe it raises new and universal questions just as relevant in Eastern Europe, the Soviet Union or China as in the third world.

We start our questioning with six general propositions. The first is that states are now competing more for the means to create wealth within their territory than for power over more territory. Where they used to compete for power as a means to wealth, they now compete more for wealth as a means to power – but more for the power to maintain internal order and social cohesion than for the power to conduct foreign conquest or to defend themselves against attack.[1] The implication is that national choices of industrial policy and efficiency in economic management are beginning to override choices of foreign or defence policy as the primary influences on how resources are allocated.

The second is that the emergence of new forms of global competition among firms also affects how states compete for wealth. As firms harness the power of new technology to create systems of activity linked directly across borders, so they increasingly concentrate on those territories offering the greatest potential for recovering their investments. Moreover, in a growing number of key sectors, the basis of competition is shifting to emphasise product quality, not just costs. Attractive sites for new investment are increasingly those supplying skilled workers and efficient infrastructures. These new demands from firms affect how governments allocate resources to attract wealth-generating investment.

The third is that small, poor countries face increased barriers to entry in industries most subject to global forces of competition. They must look to their investments in skills as a primary means of hooking into the growing international systems and avoiding constant relegation to the periphery of investors' concerns.

The fourth is that these changes have added two new dimensions to diplomacy. No longer do states merely negotiate among themselves; they now must also negotiate – if not as supplicants then certainly as suitors seeking a marriage settlement – with foreign firms. Furthermore, multinational firms themselves are increasingly having to become more statesmanlike as they seek corporate alliances, permanent, partial or temporary, to enhance their combined capacities to compete with others for world market shares. The interaction of all three dimensions, in 'triangular diplomacy', calls for new skills in management and government that challenge the old order.

The fifth is that these new dimensions have multiplied the number of possible policy options for governments and for firms, and thus have greatly complicated the problems for both of managing multiple agendas. The administrative capacity of both has now become an important determinant of who can gain most from the changes in the world economy.

The sixth is that all of these shifts have acted to increase the volatility of change and the divergence of outcomes of the new diplomacy. Many developing countries are poorly placed to respond effectively, *not* for reasons of lack of factor-cost advantages, but because of deep-seated internal obstacles. These are born of traditional attitudes, political structures and often a lack of political will to confront and resolve inherent dilemmas of choice: policies aimed at enhancing internal welfare seldom sit comfortably with those designed to enhance the efficiency needed to compete in world markets. Development thus becomes a function of nations' abilities to link and control their economic affairs co-operatively with others: policies of autarky are increasingly ineffective.

These propositions all suggest reasons why policy must become more outward-looking if states are to find a place in the sun. But *how* states both resolve increasingly intractable dilemmas and implement policy becomes a critical determinant of success. For many, the prevailing attitude expressed in more liberal attitudes towards the multinationals seems to be, perhaps grudgingly, that of saying, 'if you cannot beat them, then join them'. Yet, at the same time, many are also saying that the struggle for self-reliance must go on. There are, thus, countervailing forces at work. The creation of fruitful partnerships in production will be, we believe, a fitful process and suffer many setbacks in the years ahead. But the direction of progress seems clearly charted, even if the details are blurred.

Outline for the book

In this introductory chapter, we summarise the general line of argument to amplify these initial propositions. In chapter 2, we elaborate our contention that global structural changes – in finance, technology, knowledge and politics – have exerted a dominant influence on the behaviour of governments and firms and pushed multinational enterprises more centre-stage in the evolving international political economy. In chapter 3, we examine how structures of global competition among firms have been affected by these shifts and why they have been evolving at different rates and in different forms. We argue that governments need to understand more fully that differences in firms' abilities to master change are more important than are differences among industries. Only by looking at the relative strength of firms in an industry can the basis of lasting bargains be discerned.

The next two chapters focus on the nitty-gritty detail of action and response at local levels. In chapter 4, we examine how our three governments have formulated national and sectoral policy and attempted to resolve the dilemmas inherent in their dealings with foreign firms and with international institutions such as the World Bank, the IMF and the web of treaty organisations such as the GATT. The need for control – to ensure that firms do not cheat, as well as to ensure order in managing economic and social transformation – can conflict with the promotion of entrepreneurship. The divergence of policies and outcomes in these countries seems to us especially striking and not susceptible to interpretation by any single model of bargaining power. Chapter 5 examines the impact of the global strategies of firms on their policies in developing countries. In the specific relationships between firms and governments, how the policies of each affect the responses of the other, whether positively or negatively, is illustrated. From this it will be clear that firms seek governments that provide a stable, temperate environment, while governments look for firms that will be good citizens, productive, expanding and loyal. Chapter 6, written by John Henley, examines the social dimensions of the government–corporate relationship. Working with the grain of what is socially and politically acceptable in each country is essential if policies are to be stable and to have a chance of surviving external shocks.

In the concluding chapter we return to our six propositions and amplify them in the light of the evidence presented. Here, we expand on the notions of the new dimensions to diplomacy and examine the implications of the additive and growing matrix of agendas that determine the interaction between firms and governments. We aim to persuade our readers that a few simple models can cut through much of the complexity by linking together agendas previously kept separate. The new questions thus provoked can help to identify and explain future sources of opportunity and risk for both parties.

THE CHANGING GAME

Our propositions suggest that structural change in the international political economy has altered the nature of the game by affecting the actions and responses among firms and states. What we mean by structural change will be explained in some detail in the next chapter. But for the moment we would point to some of the more visible outcomes of greater volatility in a world of more mobile financial resources and faster technical change.

A brief catalogue of some of the major sources of dynamism in world markets illustrates the difficulties of forecasting when determining appropriate policy for developing countries with differing resources. For example, modern designs and technology allow firms to save on materials. By 1984, Japanese firms had reduced by 40 per cent the raw materials needed for each unit of industrial production in 1973 (Drucker, 1986). Such a massive reduction directly affects the commodity-exporting countries: much of the persistent weakness in the prices for many commodities seems to have as much to do with this effect as with the production cycle. Simultaneously, the costs of labour as a proportion of total costs have been falling in all developed countries. In many fabricating industries, they have fallen from 25 per cent to under 10 per cent within the last decade (Ohmae, 1985); in TV, they fell to 5 per cent in Japan by 1980 and have fallen further since. Similar falls are endemic in the information-technology industry.[2] Developing countries that have based their export strategies on low labour costs now find those advantages to be eroding. Indeed, there have been some instances where investors have pulled back their labour-intensive operations from developing to developed countries (UNCTAD, 1989).

The real costs of transport and communication have also been falling. That firms have taken advantage of the reduced costs of running a far-flung corporate empire and altered the balance between trade and investment in their strategies is shown, for example, by the fact that the value of air freight across the Pacific overtook passenger revenues in 1986. Moreover, reduced communication costs allow new *systems* of global information management to become feasible. If the 1980s were the decade of the personal computer – 110 million sold worldwide – the 1990s look set to be the decade of telecoms and other forms of electronic communication. Advantage will shift to those who can take advantage of collapsing time scales and harness the value of the signals received by innovative action.

In some sectors, these shifts have stimulated trade in intermediate goods; in others, more trade in finished goods and less in the intermediates previously produced in developing countries. Added to these changes are the increasing costs of R & D, the shortening life for many products, the new possibilities for producing variety at lower cost, and the increase in the risks for many new product ventures. These and other factors have combined to create novel, and often unpredicted, divisions of labour within and among developed and developing countries.[3] They have also changed the structure of entire industries. In the pursuit of ever lower costs and greater shares of an increasingly open world market, many firms have been propelled into taking on the challenges of what has become known as global competition.

Shifting opinion

As these changes have unfolded, the tone and substance of the debates about the role of multinational companies in developing countries have been revised. It is hard to remember that only a decade ago politicians in third world countries were almost unanimous in their castigation and condemnation of foreign companies, and that the heads of many of these companies, especially the American and European ones, held inflexible views on how they would operate in a developing country. In place of the old bitterness, bigotry and mutual incomprehension,[4] we find a new pragmatism in their mutual attitude.

For the firms, competition for a secure place in the world market has become much more acute. Managers' attitudes are adjusting as they seek new sources of competitiveness, either by internal development or in partnership. Their operations reflect, as in a mirror, the growing interdependence of national economies perceived by their opposite numbers in national governments. Few can afford to ignore the developing world, either as a market, or a source of supply, or indeed as a source of new competition. As buyers, developing countries as a whole account for a quarter of world imports, the majority of which comes from developed countries. For many multinationals, such as Komatsu in earth-moving machinery and GEC in electrical machinery, trade with developing countries can spell the difference between profit and loss. As suppliers, they provide nearly 30 per cent of world exports, 60 per cent of which is in manufactures, the more capital-intensive parts of which go to developed countries.[5] And as third world multinationals gain in stature, they add further pressure to change the rules of the competitive game. Most multinational firms recognise the importance of these issues, even those who remain unwilling to invest in developing countries.

Similarly, most developing countries feel the pressure to re-examine how foreign firms with their command of finance and technology and their access to rich markets can help offset the dire consequences of the failure of sovereign borrowing to provide a reliable and secure engine of growth. As we show in chapter 4, many have relaxed their previously stringent criteria for screening potential investors and added more generous incentives. By their actions, they are showing how far opinion has moved from the early 1980s, when one study could report that three-quarters of diplomats thought that all multinationals employed corrupt practices and policies detrimental to development.[6] They are also rejecting the conclusions of many quite recent academic studies, one of which asserted that 'the multinationals have undermined local economic and social autonomy' (Dixon *et al.*, 1986: p. 16). It is not the firms *per se* that have constrained autonomy; it is the world system in which the firms are but one set of players and are increasingly recognised as such.

There is a new hope that firms can provide poor countries with both the stimulus and some of the resources they need for economic development without unduly undermining national self-esteem. The dynamism of global structural change offers states new options and makes the future seem altogether brighter. Yesterday's straitjacket of fixed opinion can be shrugged off. Yet there are risks and uncertainties. As the next chapter shows, structural change both helps and hinders aspirations for development. Moreover, beneath the veneer of growing pragmatism and collaboration, there often lurk fears that the old possibilities for exploitation by foreign interests remain as strong as ever. Many government officials to whom we talked expressed the hope that their countries would eventually be able to break away from the current reliance on foreigners to promote their exports. The necessity they feel to dash for export-led growth can call for bedfellows that prove only temporary.

Optimism about a new rapprochement can thus be overstated: a latent hostility may remain. Besides, it is perhaps ironic that while the official climate for inward investment has improved, the investment flows into most developing countries have declined. In part, this seems to reflect the fact that most of the policy changes address the problems of the 1970s and ignore the opportunities of the 1980s. In the service sectors, where much of the new dynamism lies, old attitudes and restrictions seem as firmly implanted as ever. This is an issue that we address at the end of the book when we have shown the evidence for both optimism and pessimism about the possibilities.

Where does government policy fit in?

Liberalisation of policy combined with falling costs of cross-border transactions has rekindled old fears in many quarters that the multinationals are becoming more mobile and more stateless world citizens, divorced from the competition-distorting effects of national policy. This depiction of the multinational has been promoted by such observers as Ohmae (1990), who point to some of the outcomes described in chapter 3. In our opinion, however, Ohmae's view is perhaps no more than a portent of the long-run future: closer inspection of the evidence shows that only a few firms can hope to operate in a 'borderless' world. Governments, both host and home, continue to play a crucial, and perhaps paradoxically, an increasing role.

Porter (1990), in particular, has advanced strong arguments to show that firms draw their vitality from the conditioning forces in their home markets. He asks why some nations are more prosperous than others and why some national sectors flourish while others stagnate. He focuses attention on four factors. One is the basic structure of national factor costs, including the supply of skilled workers and an efficient infrastructure. For this he draws on earlier work in trade economics to question many of the basic assumptions of comparative advantage (Ohlin, 1933). Another is the structure of demand conditions, affected by national macro-economic policy and in turn affecting the composition of trade in ways shown earlier by such scholars as Linder (1961). Equally important are the effects of competition (echoing Schumpeter, 1942) and the impact of related and supporting industries (familiar to students of Marshall in terms of 'externalities'). His central thesis is that competitiveness is born of fierce local rivalry, an active anti-trust policy and avoidance of protectionism. 'Competing domestic rivals will keep each other honest in obtaining government support. Companies are less likely to get hooked on the narcotic of government contracts or creeping industry protectionism'. Despite the title of Porter's work, *The Competitive Advantage of Nations*, the main lines of argument apply at the level of the firm. No country can be good at everything, for only some firms and some sectors thrive within the framework established by economic management and the workings of a national culture.

Porter's analysis provides only a point of departure for many of the lines of argument advanced here. Though the basic analysis is contained in the older ESP paradigm (Koopmans and Montias, 1971), his analysis takes life from the detailed analyses of contemporary conditions. None the less, he omits detailed consideration of entrepreneurship and investment. More seriously for our purposes, he almost wholly ignores the changes in the world system outside the countries and fails to recognise the composition of government as groups of parties with different interests. He also fails to examine the interaction between the international competitiveness of local firms and government policy; a crucial issue in many developing countries (Aggarwal and Agmon, 1990). Yet his analysis can be adapted to host, developing countries. For this one needs to add more explicit treatment of government policies that balance economic with social conditions. Small, poor countries cannot afford the luxury of letting market forces determine outcomes. Besides, even in the USA, it is recognised that government action can alter the balance of factor cost advantage through intervention (Zysman and Tyson, 1983). Adding explicitly the role of government policy and the shifts of global competition to Porter's four factors produces the diagram of related influences shown in figure 1.1 below.

Rather like Toynbee's concept of challenge and response, the diagram suggests the possibility of an explanatory framework: it is not the basis of a deterministic theory. Its meaning emerges from the interactions among the variables, more in terms of what is contradicted than definitively established. By suggesting new questions, it can help articulate, but not resolve, the long-standing debate about the lines of causality between policies to create growth and those aimed at structural reform.

Causality can be seen to run in both directions. Governments may

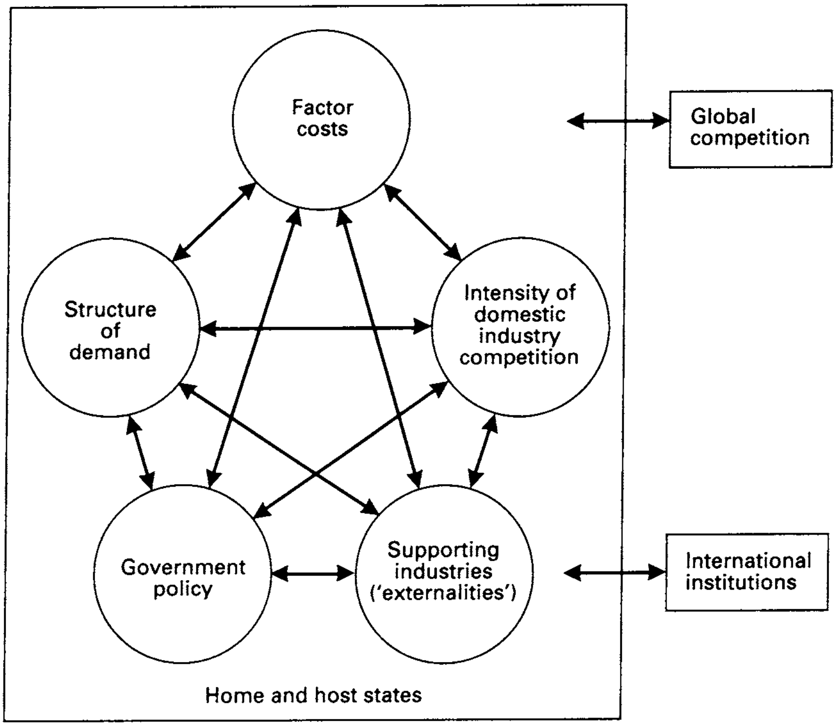


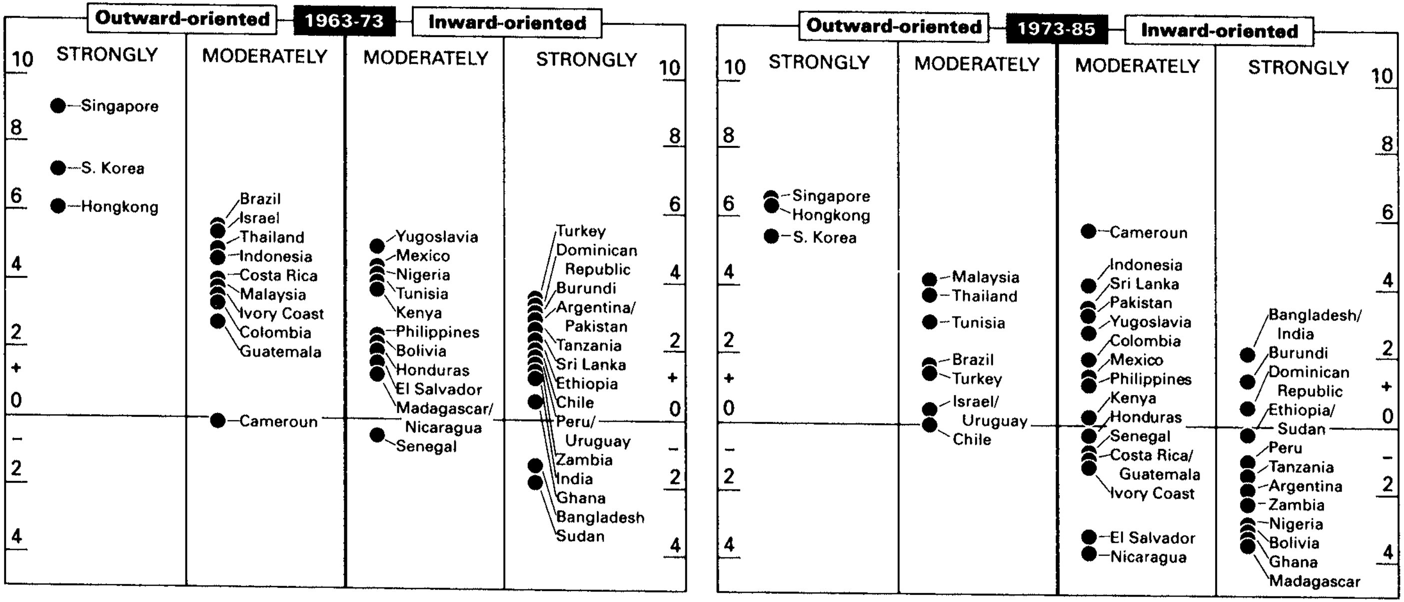
Figure 1.1 Primary factors influencing a nation's competitiveness. Adapted from Porter (1990).

either take the initiative to influence the composition of output or trade, or feel forced to respond to external changes they regard as undesirable.[7] There is therefore great uncertainty about the appropriateness of conventional prescriptions for development policy. Besides, the ability of forecasters and policy makers to pick 'winners' is low. Who would have forecasted in the 1950s that South Korea would maintain a real growth rate of 5.7 per cent for thirty years? More likely, economists would have looked at the low savings rate and considered South Korea a likely loser (Crook, 1989). Malaysia would probably have been written off on the same basis, especially given its security problems at that time.

By focusing on the role of the firm, figure 1.1 can also be used to challenge the theory of comparative advantage that has formed the basis of so much official thinking. Many economists have begun to develop new models that accord more closely with actual trade behaviour.[8] As Krugman (1987: p. 131) has said, 'these new models call into doubt the extent to which actual trade can be explained by comparative advantage: they also open the possibility that government intervention in trade . . . may under certain circumstances be in the national interest after all'. For example, in capital-intensive industries such as chemicals, the decision to build a new export-oriented refinery can disturb existing trade patterns. The location of such lumpy investments is chosen as much by the investor's calculation of advantage relative to all its existing refineries as by the national factor costs and demand function in the host country. Though we do not set out to build an omnibus theory that can embrace such calculation, we recognise that trade and national advantage must be seen in the context of the bargain struck between the investor and the host nation. Countries now compete for scarce managerial resources more by providing a favourable investment 'climate' than simply relying on factor cost advantages.

A further issue in any analysis of policy choice is the *power* of the state to implement its choices and overcome social, religious and political obstacles to change. How Brazil and South Korea responded to the problem of spiralling debt and reduced inflows of foreign capital illustrates the impact of domestic circumstance on policy and thus on the investment climate. In 1982, the Brazilian government, afraid of the social effects of the decline in capital inflows, cut investment even more severely than they cut consumption. By contrast, the Korean government, more confident of its ability to contain and suppress social unrest, acted to increase domestic saving and stepped up domestic investment to take the place of foreign loans, even though this meant a cut in real wages and consumption. Growth rates in Korea stayed high: they declined in Brazil. Brazil's choices in the 1980s reflected in part the relative weakness of its government in the aftermath of the transition to civilian rule. Weak states usually resort to approaches that can be regarded as 'making policy by default'.

Related to these choices of internal policy are those affecting attitudes towards 'outward-looking' policies. Despite the claim of bodies such as the IMF, some countries hold the view that an 'outward-looking' policy framework does not always promote growth and that inward-looking approaches can be superior. Lall (1987: p. 28) asked, 'can Tanzania become Korea only by adopting an outward-looking trade policy?'. Clearly not, when the necessary technical abilities and entrepreneurial drive is absent. The spread of growth rates under each policy regime shown in figure 1.2 below supports such agnosticism and illustrates the difficulty of drawing general conclusions. As the 1989 United Nations Conference on Trade and Development (UNCTAD) trade and development report stated,



Strongly outward-oriented
Trade controls are either non-existent or very low in the sense that any disincentives to export resulting from import barriers are more or less counterbalanced by export incentives. There is little or no use of direct controls and licensing arrangements, and the effective exchange rates for imports and exports are roughly equal.

Moderately outward-oriented
Incentives favour production for domestic rather than export markets. But the average rate of effective protection for the home markets is relatively low and the range of effective protection rates relatively narrow. The use of direct controls and licensing arrangements is limited. The effective exchange rate is higher for imports, but only slightly.

Moderately inward-oriented
Incentives clearly favour production for the domestic market. The average rate of effective protection for home markets is fairly high and the range of effective protection rates relatively wide. Direct import controls are extensive. The exchange rate is somewhat overvalued.

Strongly inward-oriented
Incentives strongly favour production for the domestic market. The average rate of effective protection for home markets is high and the range of effective protection rates wide. Direct controls and licensing disincentives to the traditional export sector are pervasive, positive incentives to nontraditional exports are few or nonexisting, and the exchange rate is substantially overvalued.

Figure 1.2 Trade regimes and growth. Adapted from *The Economist*, 23 September 1989, based on data from the World Bank.

export reforms are no guarantee of economic growth'. Besides, some of the external choices clash uncomfortably with domestic priorities. Developing effective external policy to gain internationally calculated *efficiency* to support an export drive can conflict with domestic priorities for *equity* or racial justice.

Resolving such clashes cannot be solved by rational economics alone; they must be regarded as political choices. An interview with India's prime minister in 1990 provided an illuminating vignette of the dilemma. Mr Singh had publicly acknowledged his awareness that the events in Eastern Europe and the USSR were shaking India too, and that India risked being left further behind if it did not accept the new international challenge. When asked why he had not liberalised and deregulated faster, he replied, 'We are politicians. We know our place. The people have to be persuaded first: they will understand what is confronting them when it is explained . . . but it will take time.'[9]

India's long-run performance has been much poorer than South Korea's. In 1950, both were miles behind the industrialised countries and it seemed then almost impossible for either to attain high standards of living. Today India has a per capita income of about $250 (in 1980 $) and South Korea's is roughly $2,900. Similar differences show up in Korea's far greater levels of social gains, such as greater life expectancy, education and change in the structure of the domestic economy. What caused the difference?

Though it might be tempting to attribute South Korea's greater success to its outward orientation and India's problems to its inward-looking priorities, the many differences in social and economic conditions make it impossible to provide a single answer. Besides, aggregate statistics run the risk of provoking sweeping generalisations; they obscure sectors of relative growth or relative decline. None the less, there are some important similarities and contrasts that seem to bear on the issue. For instance, both governments followed policies of strong intervention in their markets – an outward-looking policy does not necessarily mean *laissez faire*. The crucial difference is that India constrained competition, whereas South Korea actively promoted both domestic rivalry and the international development of local firms.

There is a balance to be struck. As Lawrence (1987: p. 102) said, 'an industry needs to experience rigorous competition if it is to be economically strong. Either too little or too much competitive pressure can lead an industry to a predictably weak economic performance characterized by its becoming inefficient and/or non-innovative.' This sense of required balance is a repetitive theme in the chapters that